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First National Stores Inc.
Annual Report

for the year ended March 28

1970



FINANCIAL HIGHLIGHTS

	<i>52 weeks ended</i>	
	<u>March 28, 1970</u>	<u>March 29, 1969</u>
Sales	\$770,780,000	\$692,125,000
Income before income taxes and extraordinary credits	4,821,000	1,619,000
Income before extraordinary credits	2,621,000	999,000
Net income	4,462,000	1,239,000
Per share of common stock:		
Income before extraordinary credits	1.76	.62
Extraordinary credits	1.24	.15
Net income	3.00	.77
Net working capital	24,169,000	35,118,000
Total assets	133,478,000	128,934,000
Stockholders' equity	80,333,000	85,545,000
Book value per share	57.07	53.29
Number of stores	413	444

The Annual Meeting of the Shareholders will be held at the Company's Executive Offices, 5 Middlesex Avenue, Somerville, Massachusetts, on Monday, June 22, 1970 at 10:00 A.M. Eastern Daylight Time. All Shareholders are cordially invited to attend.

TO OUR SHAREHOLDERS:

There were many positive developments within our Company during the fiscal year ended March 28, 1970. The most obvious and rewarding of these were the substantial increases in sales and earnings, both of which began in the prior year. The Company is now starting to reap the benefits of the significant investments of energy and money made during prior years.

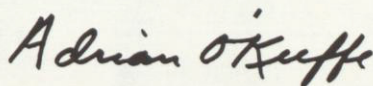
Record sales resulted from a combination of factors, the most important of which was the continuation of the improved sales pattern within identical stores, a cornerstone of our basic strategy begun three years ago. Sales in existing units are running better than 10% ahead of the prior year, an excellent increase over and above the effects of inflation. During the year we opened fourteen new stores, ten of which were replacements of outdated units. Major remodeling was completed in eleven existing stores, resulting in substantial sales improvements. A major remodel in the right location will often result in a better return than is available from a new store. Forty-five outmoded stores with limited potential were closed during the year, and these closings have worked positively for the Company.

Net income totaled \$4,462,000, a considerable improvement over the prior year, as shown in the financial highlights. The Company uses the LIFO method of inventory valuation, which is further explained on page 2. LIFO this year effected a reduction of our pretax earnings of \$1,603,000. Last year the effects of LIFO upon our reported pretax earnings resulted in a reduction of \$670,000.

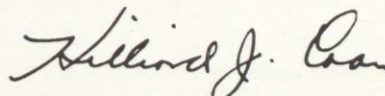
Management strength is contributing greatly to the growth of the Company, and we consider this to be one of our major assets. All Divisions of the Company are under the direction of aggressive management teams, and operate with an increasing degree of local autonomy. Operating and merchandising policies are directed towards local response on an individual store basis, and this has had a marked effect on the previously mentioned success in identical stores. An incentive program for executive personnel has been developed which we believe will further strengthen the participation, effort and drive of our people needed to maximize and sustain the operating strength of our Company. It is our intent to continue to develop and offer incentives to all management people at every level of the Company.

There are a great many uncertainties in our economy today, but we look forward with optimism to a continuation of our strong recovery pattern. The support that we are receiving from our customers, employees and stockholders is sincerely appreciated.

Respectfully submitted,



ADRIAN O'KEEFFE
Chairman of the Board



HILLIARD J. COAN
President

FINANCIAL REVIEW

A new sales record was set in the year ended March 28, 1970. Consolidated sales were \$770,780,000, an increase of 11.4% over the \$692,125,000 reported last year.

Net income for fiscal 1970 amounted to \$4,462,000 or \$3.00 per share, as compared with \$1,239,000 or \$.77 per share last year. Extraordinary credits included in this year's net income totaled \$1,841,000 or \$1.24 per share arising from the sale of a former food distribution warehouse and from the benefits of the tax loss carryforward. Last year's net income included an extraordinary credit of \$240,000 or \$.15 per share from the benefits of the tax loss carryforward.

The LIFO method of inventory valuation resulted in a pretax charge of \$1,603,000 and an after tax charge of \$766,000 or \$.51 per share. In the prior fiscal year the pretax charge amounted to \$670,000 and the after tax charge was \$317,000 or \$.20 per share. These charges against earnings are directly related to rising costs of merchandise. The Company is one of the very few publicly-owned supermarket chains using LIFO. Earnings are reported lower than if the Company was not on LIFO, but substantial cash and tax benefits adequately compensate for this difference. Since its adoption in 1942, the Company has accumulated a LIFO reserve of \$12,597,000 against inventories. Had it not used LIFO the Company would have reported approximately half of the \$12,597,000 in earnings and paid the remaining half of this reserve in income taxes.

A federal income tax provision was made during the year on the basis of the taxes which would have been payable had the Company not had a net operating loss carryforward (see Note 5 to the financial statements). For federal income tax purposes there remains a net operating loss carryforward of approximately \$1,000,000 and an investment tax credit carryforward of approximately \$900,000. It is expected that the Company will have federal income taxes payable in the current fiscal year.

In August, 1969, the Company made an offer to purchase from its stockholders shares of the Company's common stock at \$40.00 per share. At the conclusion of the offer, the Company purchased 200,000 shares of the common stock tendered. The Company now has 247,664 shares held in the treasury which may be used for possible future acquisitions and for other corporate purposes including employee incentive programs.

Net capital expenditures for fiscal 1970 amounted to \$12,757,000, compared with \$5,306,000 in the prior year. The largest portion of the expenditures was for stores and related equipment.

The Board of Directors declared four dividends of 25 cents per share, a total of \$1.00, which amounted to \$1,506,000 on the shares of common stock outstanding. A dividend of 25 cents per share payable July 1, 1970, to stockholders of record June 2, 1970, was declared on May 12, 1970.



REVIEW OF OPERATIONS

Supermarket sales during the year continued to show quarterly improvement, with the March Quarter marking the ninth successive thirteen-week period to post an increase. During the last two years, annual sales have increased by approximately \$125,000,000, with sixty-eight fewer stores in operation. Consistent management objectives have been to increase average store sales and to

increase sales in identical stores. The continued achievement of both objectives has been most satisfying.

At the close of the fiscal year, the Company was operating 413 supermarkets, a net reduction of 31 from 444 at the close of the prior year. During the year, fourteen new supermarkets were opened, ten of which were replacements of existing stores. In addition, major remodels were completed in eleven supermarkets. During the current fiscal year, we plan to open twelve new stores and are planning twenty major remodels of existing stores.

The real estate and construction department, a key element in the Company's growth pattern, was restructured during the year. Major emphasis is being placed on the development of high-volume stores with larger sales areas, incorporating more service departments and customer conveniences.



We are developing and improving service delicatessen departments, in-store bakeries, florist departments, service meat and luncheonettes. Most of last year's new and remodeled stores include one or more of these departments. Complementing the new customer service departments, a modern interior decor was introduced during the year and has met with a most favorable response. Our stores are now tailored to the neighborhood, more exciting

and more fun to shop in. An in-store pharmacy was opened in April of this year in a remodeled store, bringing to three the number of pharmacies now operated.

As announced in the last annual report, our One Stop Institutional Foods, Inc. subsidiary acquired the net assets and business of the Suffolk Grocery company on April 24, 1969. During the year, the facilities of Suffolk were moved into existing space in our distribution center in Somerville. On April 25, 1970, an institutional meat supplier was acquired by Suffolk, and the operation is now ready to embark on its full-service concept. During this transitional period, Suffolk had sales of \$7,351,000.

The service arms of our business are receiving continual attention. The data processing department was centralized in Somerville and expanded during the year. Our communications system is undergoing improvements with the eventual objective of direct store contact with the computer center. Many of our accounting procedures are now computerized. The warehousing and transportation departments are continuing to strive for better service to our stores. Reducing the lead-time for store ordering cycles, more frequent and improved delivery service, a case labeling sticker system are all directed towards better store operations and increased customer satisfaction.

A requisite to good operating procedures is professional management and the Company is allocating much of its efforts and resources to further develop this professionalism in its people. Training programs are in effect not only to teach improved methods of operation, all of which contribute to greater productivity, but also to impart the participative management style that is necessary to the success of the Company. Store management today involves diversified responsibilities and the development of our Managers to the point where they have control over their operation is paramount. The Company is most fortunate to have men of the calibre necessary to fill this key management position.



ASSETS

	MARCH 28 1970	MARCH 29 1969
Current assets:		
Cash	\$ 9,724,000	\$ 10,973,000
Short-term investments, at cost (approximate market)	3,092,000	9,898,000
Accounts receivable, less allowance for doubtful accounts — \$400,000 in 1970 and \$187,000 in 1969	7,729,000	4,314,000
Inventories, at cost (substantially on the basis of last-in, first-out) or market whichever is lower	48,369,000	43,293,000
Prepaid expenses and other current assets	5,473,000	6,568,000
Total current assets	<u>74,387,000</u>	<u>75,046,000</u>
Fixed assets, at cost:		
Land	8,426,000	7,773,000
Buildings owned	30,717,000	31,583,000
Store fixtures, leasehold improvements, machinery and equipment	95,696,000	87,812,000
Automotive equipment	8,369,000	7,767,000
	<u>143,208,000</u>	<u>134,935,000</u>
Less — Depreciation and amortization (Note 2)	86,419,000	84,135,000
	<u>56,789,000</u>	<u>50,800,000</u>
Other assets and deferred charges	2,302,000	3,088,000
	<u>\$133,478,000</u>	<u>\$128,934,000</u>

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BALANCE SHEET

LIABILITIES

	MARCH 28 1970	MARCH 29 1969
	<u> </u>	<u> </u>
Current liabilities:		
Accounts payable	\$ 34,390,000	\$ 25,024,000
Accrued expenses	15,209,000	14,236,000
Current portion of long-term debt	267,000	267,000
Dividend payable	352,000	401,000
Total current liabilities	<u>50,218,000</u>	<u>39,928,000</u>
 4.70% Notes, due in equal semiannual instalments to 1976	 <u>2,927,000</u>	 <u>3,461,000</u>
 Stockholders' equity (Note 3):		
Common stock, without par value:		
Authorized — 2,000,000 shares		
Issued — 1,655,268 shares	31,926,000	31,977,000
Retained earnings	58,341,000	55,385,000
	<u>90,267,000</u>	<u>87,362,000</u>
 Less — Treasury stock, at cost — 247,664 shares in 1970 and 50,064 shares in 1969	 <u>9,934,000</u>	 <u>1,817,000</u>
	<u>80,333,000</u>	<u>85,545,000</u>
 Lease commitments (Note 4)		
	<u><u>\$133,478,000</u></u>	<u><u>\$128,934,000</u></u>

FIRST NATIONAL STORES INC.
CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

52 WEEKS ENDED

	MARCH 28 1970	MARCH 29 1969
Sales	\$770,780,000	\$692,125,000
Gain on disposal of fixed assets — net	38,000	894,000
Other income	1,262,000	715,000
	<u>772,080,000</u>	<u>693,734,000</u>
Costs and expenses:		
Cost of sales, warehousing, transportation and store occupancy expenses	643,351,000	574,825,000
Direct selling, advertising, general and administrative expenses	116,956,000	110,040,000
Depreciation and amortization (Note 2)	6,769,000	7,027,000
Interest expense	183,000	223,000
	<u>767,259,000</u>	<u>692,115,000</u>
Income before federal income taxes and extraordinary credits	4,821,000	1,619,000
Provision for federal income taxes (Note 5)	2,200,000	620,000
Income before extraordinary credits	<u>2,621,000</u>	<u>999,000</u>
Extraordinary credits:		
Gain on sale of warehouse, less provision of \$140,000 for federal income taxes	361,000	—
Elimination of charge in lieu of federal income taxes arising from carry-forward of prior year net operating loss (Note 5)	1,480,000	240,000
	<u>1,841,000</u>	<u>240,000</u>
Net income	4,462,000	1,239,000
Retained earnings at beginning of year	55,385,000	54,547,000
Cash dividends declared — \$1.00 per share in 1970; \$.25 per share in 1969	(1,506,000)	(401,000)
Retained earnings at end of year	<u>\$ 58,341,000</u>	<u>\$ 55,385,000</u>
Per share of common stock:		
Income before extraordinary credits	\$1.76	\$.62
Extraordinary credits	1.24	.15
Net income	<u>\$3.00</u>	<u>\$.77</u>
Shares outstanding — weighted average	1,488,865	1,605,204

CONSOLIDATED STATEMENT OF SOURCE AND USE OF FUNDS
YEAR ENDED MARCH 28, 1970

Source of funds:	
Net income	\$ 4,462,000
Depreciation and amortization	6,769,000
Provision for federal income taxes not currently payable	860,000
	<u>12,091,000</u>
Use of funds:	
Acquisition of treasury stock less proceeds received on exercise of stock options	8,168,000
Net additions to fixed assets	12,757,000
Cash dividends declared	1,506,000
Reduction in long-term debt	534,000
Other, net	75,000
	<u>23,040,000</u>
Decrease in working capital	<u>\$10,949,000</u>

FIRST NATIONAL STORES INC.

NOTES TO FINANCIAL STATEMENTS

NOTE 1—PRINCIPLES OF CONSOLIDATION

The accompanying consolidated financial statements include the accounts of First National Stores Inc. and its subsidiaries. All intercompany transactions have been eliminated. During fiscal 1970, the Company purchased for cash the net assets of Suffolk Grocery Co., Inc. and two other minor companies. These acquisitions have been accounted for as purchases.

NOTE 2—DEPRECIATION AND AMORTIZATION POLICIES

For financial statement purposes, depreciation and amortization are computed under the straight-line method for assets acquired subsequent to March 26, 1966 and primarily under the sum-of-the-years digits method for previous acquisitions. Estimated useful lives are as follows:

Buildings owned	20-50 years
Store fixtures, leasehold improvements, machinery and equipment	8-25 years
Automotive equipment	3-8 years

NOTE 3—COMMON STOCK AND RETAINED EARNINGS

As of March 29, 1969 options to purchase 61,350 shares of the Company's common stock were held by certain officers and key employees of the Company. During the year options for 11,550 shares were issued, options were exercised to purchase 4,050 shares at prices ranging from \$27.125 to \$30.50 per share and options for 5,100 shares terminated. The excess of the average cost of the treasury shares over the option price for options exercised has been charged to common stock. At March 28, 1970 options for 63,750 shares were outstanding at prices ranging from \$27.125 to \$64.25 per share, of which options for 23,962 shares were then exercisable. The options become exercisable in equal annual instalments over a four-year period beginning one year after the date granted. Additional options for 7,200 shares may be granted at prices no less than the fair market value at the date of grant and such options expire not more than five years after the date granted. The options do not have a dilutive effect and accordingly are not reflected in the computation of earnings per share.

At March 28, 1970 the portion of retained earnings available for the payment of cash dividends and acquisition of the Company's common stock was approximately \$3,550,000 as calculated in accordance with the terms of the loan agreement covering the long-term debt.

NOTE 4—LEASE COMMITMENTS

At March 28, 1970 the Company was committed under leases covering stores and other properties. The minimum annual rentals under these leases amount to approximately \$10,700,000 exclusive of real estate taxes and other expenses or additional rentals based on percentage of sales. Of the minimum annual rental commitment, approximately 58% related to leases expiring within 10 years and approximately 90% to leases expiring within 15 years.

NOTE 5—FEDERAL INCOME TAXES

No federal income tax payments are required for 1970 due to the Company's net operating loss carryforward. Federal income taxes in the consolidated statement of income is as follows:

	1970	1969
Charge equivalent to reduction in income taxes arising from the use of accelerated depreciation for tax purposes	\$ 715,000	\$ —
Amortization of prepaid taxes arising from depreciation charged to income in prior years	305,000	380,000
	1,020,000	380,000
Less—investment tax credit	300,000	—
	720,000	380,000
Charges equivalent to net operating loss benefits realized	1,480,000	240,000
	\$2,200,000	\$ 620,000

The Company's book loss carryforward has been fully utilized. For tax purposes a net operating loss carryforward of approximately \$1,000,000 is available through 1974 as a credit against future taxable income. This carryforward arises principally from the use of accelerated depreciation for tax purposes. The tax benefit realized in 1970 resulting from this book-tax timing difference was applied to the deferred tax account.

The provision for deferred taxes has been reduced by the amount of investment tax credit that could have been claimed had taxes payable been based on the higher book income. The Company has at March 28, 1970 unused investment tax credits amounting to approximately \$900,000 for tax purposes, of which \$300,000 has been recognized this year for accounting purposes.

NOTE 6—PENSIONS

The Company maintains a trustee noncontributory pension plan. It has been determined that no contribution to the Company plan is required as a result of actuarial gains resulting from a change in the interest assumption and transfer of employees to various union pension plans plus a portion of the unrealized appreciation in the current fund. Total pension costs charged to earnings representing contributions to union plans was \$1,990,000.

FIRST NATIONAL STORES INC.
FIVE-YEAR REVIEW (in thousands of dollars)

Fiscal years ended in March	1970	1969	1968	1967	1966
OPERATIONS					
Sales	\$770,780	\$692,125	\$640,116	\$641,896	\$684,898
Income (loss) before extraordinary credits	2,621	999	(6,644)	(976)	2,404
Extraordinary credits	1,841	240	—	280	—
Net income (loss)	4,462	1,239	(6,644)	(696)	2,404
FINANCIAL POSITION					
Current assets	74,387	75,046	66,611	72,557	65,773
Current liabilities	50,218	39,928	31,701	32,044	23,666
Net working capital	24,169	35,118	34,910	40,513	42,107
Ratio of current assets to current liabilities	1.48	1.88	2.10	2.26	2.78
Fixed assets, net	56,789	50,800	51,624	57,833	59,017
Total assets	133,478	128,934	123,068	132,017	125,824
Long-term debt	2,927	3,461	3,995	4,529	6,131
Stockholders' equity	80,333	85,545	84,707	92,246	96,027
PER SHARE OF COMMON STOCK					
Net income (loss)*	3.00	.77	(4.14)	(.43)	1.47
Cash dividends declared	1.00	.25	.50	1.50	2.50
Stockholders' equity	57.07	53.29	52.77	57.34	58.86
OTHER DATA					
Capital expenditures, net	12,757	5,306	5,140	4,626	6,311
Depreciation and amortization	6,769	7,027	7,634	8,960	10,468
Shares of common stock outstanding (at year end)	1,407,604	1,605,204	1,605,204	1,608,604	1,631,404
Number of stores (at year end)	413	444	481	517	573

*Based on the weighted average of shares outstanding during the year.

REPORT OF INDEPENDENT ACCOUNTANTS

TO THE BOARD OF DIRECTORS AND STOCKHOLDERS OF FIRST NATIONAL STORES INC.

In our opinion, the accompanying consolidated balance sheet, the statement of income and retained earnings and the statement of source and use of funds present fairly the financial position of First National Stores Inc. and its subsidiaries at March 28, 1970 and the results of their operations and the supplementary information on funds for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Our examination of these statements was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

225 Franklin Street
 Boston, Massachusetts
 May 19, 1970

PRICE WATERHOUSE & CO.



DIRECTORS

- *HILLIARD J. COAN, *President*
- MAURICE T. FREEMAN, *Investment Trustee*
- *ALAN L. HABERMAN, *Executive Vice President*
- JOHN E. LAWRENCE, *Partner, James Lawrence & Co.*
- JOHN F. LEBOR, *Director of Several Corporations*
- EDWARD A. MERKLE, *President, Madison Fund, Inc.*
- *ADRIAN O'KEEFFE, *Chairman of the Board*
- BERNARD M. O'KEEFFE, *Retired Executive of the Company*
- WILLIAM A. RYAN, *Vice President, Secretary and Clerk*
- *Member of Executive Committee

OFFICERS

- ADRIAN O'KEEFFE, *Chairman of the Board*
- HILLIARD J. COAN, *President*
- ALAN L. HABERMAN, *Executive Vice President*
- AUSTIN F. LYNE, *Vice President*
- JOHN W. MACNEIL, *Vice President*
- JOHN F. MARTIN, *Vice President*
- RICHARD M. O'KEEFFE, *Vice President*
- PETER C. QUINN, *Vice President*
- WILLIAM A. RYAN, *Vice President, Secretary and Clerk*
- WILLIAM A. FERRARA, *Treasurer*
- ROBERT B. MCCANN, *Controller*

TRANSFER AGENTS

- THE FIRST NATIONAL BANK OF BOSTON, *Boston, Massachusetts*
- CHEMICAL BANK, *New York, New York*

REGISTRARS

- STATE STREET BANK AND TRUST CO., *Boston, Massachusetts*
- BANKERS TRUST CO., *New York, New York*

COUNSEL

- LYNE, WOODWORTH & EVARTS, *Boston, Massachusetts*
- ROPES & GRAY, *Boston, Massachusetts*

INDEPENDENT ACCOUNTANTS

- PRICE WATERHOUSE & CO., *Boston, Massachusetts*

EXECUTIVE OFFICES

- 5 Middlesex Avenue, *Somerville, Massachusetts*

DISTRIBUTION CENTERS

- Somerville, Massachusetts*
- East Hartford, Connecticut*
- South Kearney, New Jersey*

